# The final cut

Management of taxes Personal tax


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*Tessa Lorimer* looks at the impact of the Supreme Court judgment in the *Eclipse 35* case

## Key Points

## What is the issue?

Historically, film schemes have exploited the tax breaks that were originally introduced to encourage investment in the industry. By artificially structuring the scheme, however, film scheme promoters generated losses for the investors, which they could then use against other tax liabilities and in some cases generated a rebate.

## What does it mean to me?

The Supreme Court judgment against film scheme Eclipse 35 has provided a high-profile illustration of HMRC's determination to combat film schemes.

## What can I take away?

When weighed in the balance, launching claims against intermediaries, advisers and banks is preferable and more likely to succeed than is pitching oneself against HMRC. The progress of recent cases and the clear position of HMRC and the courts all suggest that investors should accept the scale of their predicament and seek a solution that offers significantly better prospects of success.

The Supreme Court judgment against film scheme Eclipse 35 has provided a high-profile illustration of HMRC's determination to combat film schemes. The hearing on 13 April 2016 assessed an appeal by the Eclipse 35 partnership to overturn judgments from the Lower and the Upper Tier tax tribunals and the Court of Appeal. Without taking time to reserve judgment, the court rejected the appeal and at the same time dashed the investor's hopes.

Historically, film schemes have exploited the tax breaks that were originally introduced to encourage investment in the industry. By artificially structuring the scheme, however, film scheme promoters generated losses for the investors, which they could then use against other tax liabilities and in a significant nuber of cases a rebate was generated.

Eclipse 35 boasted a partnership of around 287 investors, purportedly including high-profile figures from the sports world, such as Sir Alex Ferguson and Sven-Göran Eriksson, as well as City businesspeople, including David Casterton and Philippa

Rose. The partnership invested £840m in the scheme, much of which had been borrowed from banks. For an investment of around £170,000, the investors expected to obtain around £400,000 in tax relief.

HMRC targeted the scheme, arguing that the partnership was not carrying out a trade denied income tax relief to its high net worth investors. Both tax tribunals agreed with HMRC, as did the Court of Appeal, and Eclipse 35 took the case to the Supreme Court.

In April, the Supreme Court gave the investors short shrift and refused them permission to appeal. This final unsuccessful outcome will have a huge impact on the investors, who will have to repay potentially in excess of four times their original outlay as well as the cost of several years of legal representation. The ramifications of this decision is also likely to affect investors in similar schemes since it is highly likely that HMRC will pursue them with follower notices and accelerated payment notices (APNs).

The government's anti-tax avoidance drive has been widely publicised, and the political will and resources to enable HMRC to pursue it are in place. HMRC will undoubtedly target any scheme that exploits a tax incentive in a way that the government never intended.

Investors and promoters have attempted to use various legal approaches in response to HMRC's crackdowns on film schemes in particular. Successive court appeals against tribunal decisions and judicial review applications against some of HMRC's powers such as that to issue APNs or a partner payment notices (PPNs) have slowed down these cases but they have not been overly successful in general. More often, the investor has been left with substantial legal fees as well as an exorbitant tax bill.

Does this mean that tax scheme investors are left without any further recourse? Arguably there is no sense in investing further money in mounting legal actions to challenge HMRC; the best option is to reach a settlement with the department to minimise the risk of further penalties and sanctions.

Despite this capitulation, however, there are other ways for investors to try to recoup the loss incurred in settling their tax liabilities. Some types of investors will have a good case against banks, financial advisers and other intermediaries for misselling the investment. Under the Financial Services and Markets Act 2000, backers must be ‘sophisticated investors’ before they can finance types of schemes such as those for films. A sophisticated investor is defined by the Act as:

- members of a network or syndicate of business angels;
- having made more than one investment in an unlisted company in the previous two years;
- having worked in a professional capacity in the private equity sector, or in the provision of finance for SMEs; or
- having been a director of a company with an annual turnover of at least £1m within the previous two years.

Many film scheme investors, such as footballers, musicians and entertainers, do not fit into the above criteria, even though their financial adviser may have certified them as a sophisticated investor and they have been mis-sold these business deals.

Investors who believe that they were misadvised about buying into a scheme should consider two potential targets. First, the promoter of the scheme, who designed and marketed it to investors through intermediaries; and, second, the intermediary or adviser who persuaded them to sign up. In the case of the promoter, the claim will most probably be negligent misstatement, on the basis that the marketing of the scheme contained incorrect information.

When dealing with intermediaries, the claims will most likely be for breach of contract, negligent misstatement and/or negligence. In such circumstances, the investor could look at recovering losses such as penalties and interest paid, as well as the expense involved with litigation. Intermediaries, including IFAs, accountants and banks, would be more worthwhile targets for investors. This is because, in general, they have more established businesses and, more importantly, they are likely to have professional indemnity insurance cover. Many tax scheme promoters will have moved their assets offshore in harder-to-reach places to avoid being pursued for claims of negligence and breach of contract.

One important consideration is that negligence and breach of contract claims both have limitation periods of six years starting from the date of the cause of action. The main difference between the two types of claim is that in cases of negligence there is a further provision which puts back the limitation period to three years from the date the investor learned that they might have had a claim. This may create problems for some potential cases since it could be argued that promoters who aim to steer their partnerships through drawn-out court battles are using this tactic to consume this time limitation.

The possibility of using the courts to seek redress from promoters and intermediaries has improved since May 2000 and it is now possible for class actions to be brought in the High Court. This is convenient when claims give rise to common or related issues of fact or law. In such a case, the court may make a group litigation order (GLO), though it is necessary for each potential member to make an individual claim first. This, along with the application to register as part of the GLO, enables the court to determine whether the litigants are qualified to be a member.

GLOs have the advantage of enabling their members to let others deal with most of the claim process while spreading the legal costs more widely. In many circumstances, litigation funding from third parties may also be available. This works well for investors in the public eye such as football players, who will not necessarily have much experience of litigation and feel less exposed as part of a group.

## Conclusion

When weighed in the balance, launching claims against intermediaries, advisers and banks is preferable and more likely to succeed than is pitching oneself against HMRC. The progress of recent cases and the clear position of HMRC and the courts all suggest that investors should accept the scale of their predicament and seek a solution that offers significantly better prospects of success.